

LESSON 16

ANDREW JACKSON AND THE SECOND BANK OF THE UNITED STATES

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LESSON DESCRIPTION

The students participate in a simulation that demonstrates how banks create money and facilitate exchange and economic growth. The simulation provides a basis for the students' subsequent examination of Andrew Jackson's veto of the recharter of the Second Bank of the United States. They read an account of events surrounding the veto and write a short essay stating their reasons for agreeing or disagreeing with Jackson's decision.

MYSTERY

Banks are vital institutions in economies characterized by specialization and exchange. They provide money to make exchange easier and to help economies grow. Any U.S. president, one might suppose, would value banks for their role in fostering economic activity. But President Andrew Jackson distrusted banks generally, and in 1832 he vetoed an act of Congress that would have rechartered the Second Bank of the United States. Why did President Andrew Jackson make it his personal crusade to destroy the Second Bank of the United States?

ECONOMIC HISTORY

Economists define *money* as anything that is freely accepted in exchange for goods and services. In the period between the end of the Revolution and the beginning of the Civil War, most Americans would have said that money was gold and silver coins. In fact, however, most exchanges between buyers and sellers during this time involved bank notes rather than gold and silver. (In many isolated areas, barter was still the most common way of making exchanges.) Checks were an increasingly important medium of exchange in the business community, although individuals and families did not use them.

Banks are *financial intermediaries* — that is, they bring together savers (who have more

money than they want to spend) with borrowers who want to obtain more money. Banks also add to the total amount of money in circulation.

Banks in the nineteenth century created new money when they made loans, as banks today still do. The money that banks added to the amount of money in circulation was vital to the United States in the nineteenth century, since gold and silver coins were quite scarce in comparison to the production and exchange needs of the rapidly growing economy. However, the capacity of banks to create money was endangered by frequent panics, when bank customers would line up to withdraw all their deposits, often forcing banks into ruin and reducing the amount of money in circulation.

Opposition to banks was widespread in the western states, where banks tended to be more unstable. The state of Nebraska even outlawed all banks for a time. Bank opponents argued that gold and silver were the only true forms of money. Business people usually supported banks, reasoning that the quantity of gold and silver available was much too small for the volume of economic activity occurring in the growing nation. But Andrew Jackson, the candidate of the “common man,” who was elected president in 1828, despised banks and, with some reason, focused his animosity on the Second Bank of the United States and its president, Nicholas Biddle.

CONCEPTS

- Financial intermediation
- Fractional reserve banking
- Medium of exchange
- Money
- Specialization and exchange

OBJECTIVES

Students will:

1. Understand the role of money in an economic system and how banks create money.
2. Identify arguments in favor of and against Jackson's veto of the bill to recharter the Second Bank of the United States.

CONTENT STANDARDS

Economics

- Money makes it easier to trade, borrow, save, invest, and compare the value of goods and services. (NCEE Content Standard 11)

History

- The extension, restriction and reorganization of political democracy after 1800. (Era 4, Standard 3, National Standards for History)

TIME REQUIRED

45 minutes

MATERIALS

- Approximately 36 Quarterbacks cut from Activity 16.1 (You may wish to copy the Quarterbacks onto green paper.)
- A transparency of Visual 16.1
- A copy of Activity 16.2 for each student

PROCEDURE

1. Tell the students that, before the American Revolution, the British forbade the establishment of banks in the American colonies. This policy created a hardship. Exchanging money for goods or services is much more efficient than bartering, but money was in chronically short supply in the colonies. There never seemed to be enough money for people to use in ordinary transactions. After the Revolution, many new banks were founded. These banks were privately owned but were chartered by state governments. There was no Federal Reserve System, as there is

today, to monitor bank activities.

2. Ask questions to get the students started in thinking about banks and their role in an economy:
 - Why are banks important in the U.S. economy? (*Possible answers: To keep customers' money safe; to make loans.*)
 - What is money? (*The students are likely to say that money is coins, currency and checks. Tell them that this is correct as far as it goes, but more generally money is anything that is freely accepted in exchange for goods and services.*)
3. Introduce *specialization* as a concept that helps to explain why money is important. When people in an economy specialize in the goods and services they produce, they depend more and more on using money when they exchange their goods or services for goods and services produced by others. For example: You specialize in teaching American history, but you would be in trouble if you tried to pay for a tank of gas by offering the gas station cashier a 15-minute lecture about the causes of the Civil War. Call on the students to provide other examples to develop the point.
4. By reference to the previous examples, explain that money is a *medium of exchange*. It enables people who specialize in producing one good or service to exchange their product for someone else's product. Anything is money if it is widely accepted for goods or services offered for sale in an economy. People accept something as money if they have faith that they can exchange it for the goods and services that they want.
5. To elaborate this point, tell the students about things that some people have used as mediums of exchange in the past. These include wampum, used by northeastern Native Americans (and by European-Americans who traded with them); fish-hooks, used by some Pacific Islanders; and gopher tails used in the Dakotas late in the nineteenth century. As these examples show, the important thing about money is

not that it is any particular object, or made from any particular substance. Money is whatever performs well as a medium of exchange in a particular society.

6. To begin the simulation, ask the students to take out all the quarters they have. Tell them that you are going to start a bank to keep their quarters safe. Collect quarters from the students. Select one student as a teller. Display Visual 16.1. Have the teller record on Visual 16.1 the name of each student and the number of quarters each student has deposited.
7. Give out Quarterbacks from Activity 16.1 to each depositor in exchange for the quarters he or she has deposited. Tell the depositors that each Quarterback note is a receipt; they can bring in one or more of these notes at any time and get quarters back from the bank without any questions being asked. Put the quarters in an accessible place, such as your pocket or your desk.
8. Tell the students that the Quarterbacks now held by several depositors will probably work as well (at least within this classroom) as the actual quarters as a medium of exchange. After all, anyone who holds a Quarterback note can take it to the bank at any time and get a quarter for it. The note is “backed” by the quarter on deposit at the bank. Therefore, people in the area, if they trust the banker, probably will accept bank notes in exchange for goods and services. When this happens, the bank notes become money.
9. Ask: How much money is now in circulation? *(The amount of money in circulation is the same as the value of all the quarters in the bank. The quarters in the bank are NOT money as long as they are in the bank’s vault rather than circulating in the community, helping people to make exchanges.)*
10. Now ask whether any students in the class might like to borrow some quarters — to buy lunch, perhaps, or to buy school supplies, tickets to the football game, and so on. Make loans to students who request

them by using additional Quarterbacks. Have the teller record each loan on Visual 16.1, denoted in each case by the number of quarters loaned.

11. Explain that the people students buy things from will accept the bank notes because each note is backed by quarters at the bank. Point out that anyone who acquires bank notes created by lending has the same right to exchange them for quarters at the bank as do the original depositors. Ask the students what the total money supply is now. *(It is all the bank notes.)*
12. By comparing the number of bank notes in circulation to the number of quarters in the bank, show the students that the notes are no longer backed 100 percent by quarters on deposit. In light of this fact, ask: Is the bank in trouble? *(They may say that it is.)*
13. Explain that the bank probably is not in trouble as long as the ratio of bank notes to quarters is not too large. Why? Because depositors don’t generally come to the bank all at the same time to redeem their quarters (or, in the nineteenth century, their gold or silver coins). Paper money is easier to carry around than a big bag of coins. On any one day, some people might come to the bank to withdraw coins, but others would be just as likely to come in to deposit coins. If there was a shortfall of deposits, moreover, the bank could probably deal with it by borrowing. Banks in the nineteenth century were usually able to borrow from a nearby bank to cover times when withdrawals substantially exceeded deposits.
14. Introduce the concept of *fractional reserve banking*. Explain that depositors’ willingness to leave cash on deposit for long periods of time is the basis for fractional reserve banking — a system in which a relatively large amount of money can be created on the basis of a smaller amount of something of value on deposit (like the quarters in the classroom example, or gold and silver in the nineteenth century, or

deposits at the Federal Reserve Banks today).

15. Pose this question to one of the students who has deposits at your bank: Suppose that one day I am seen at the travel agency buying a one-way ticket to Rio de Janeiro. What will you probably do? *(That student and other depositors would probably hurry to the bank to withdraw their quarters, starting a “bank run.” Since the value of the bank notes in circulation is greater than the value of the quarters in the vault, there is a strong possibility — if the banker is engaged in suspicious activity and people rush to get their money back — that not all bank notes will be redeemed.)*
16. Continue the line of questioning about consequences of a bank run. Ask: If we had a run on our classroom bank, so that it ran out of quarters and had to close its doors, would Quarterbacks still be money? *(They would not be money because no one would accept them in exchange for goods and services.)*
17. Tell the students that banks today do engage in fractional reserve banking. However, instead of making loans by giving out notes, bankers today add figures to the checking accounts of borrowers, against which the borrowers can write checks. And today deposits at banks are protected by the Federal Deposit Insurance Corporation (FDIC), which has almost entirely put an end to bank runs and bank failures.
18. Ask the students to pretend they are living in the first half of the nineteenth century, when banks operated in much the same fashion as the Quarterback Bank. Ask them to identify what the main advantages and disadvantages of having a bank in your community would be. *(Advantages: People would have a [usually] safe place to keep money, in accounts that pay interest on deposits. Also, the community would benefit from greater economic activity, since business people and farmers would be able to borrow money in order to*

carry out business activity. The main disadvantage would be that if a bank went broke, some money would actually cease to exist — depriving individuals of their savings and also reducing the amount of money available to facilitate exchanges and to lend to producers.)

19. Give each student a copy of Activity 16.2. Allow 20 or 25 minutes for students to read the Activity and answer the question at the end on a separate piece of paper.

CLOSURE

Collect the students’ papers and ask some of the students to discuss their opinions of Jackson’s veto of the bank recharter. *(Possible Answer: Students who support Jackson will probably cite Biddle’s aggressive actions as proof that the bank was too powerful, while students who argue against the veto will emphasize the importance of money creation to the economy. Many American history textbooks still blame the destruction of the bank for a period of inflation from 1836 to 1837 and for the Panic of 1837, but economic historians such as Peter Temin have demonstrated that this was not a major factor in either event.)*

ASSESSMENT

Multiple-Choice Questions

1. In the pre-Civil War period, bankers increased the quantity of money in circulation when they
 - A. took deposits of gold and silver from their customers.
 - B. made loans by issuing bank notes backed by the gold and silver in their vaults.**
 - C. lent gold and silver coins to their customers.
 - D. redeemed their notes and checks by paying the Bank of the United States in silver or gold.

2. Banks failed in the pre-Civil War period
 - A. **when the depositors wanted to withdraw more of their gold and silver than the bank had in its vaults.**
 - B. whenever banks issued more bank notes than were backed 100 percent by the gold and silver in their vaults.
 - C. when Andrew Jackson outlawed fractional reserve banking.
 - D. when the Independent Treasury System was established.

ESSAY QUESTIONS

1. Explain how banks contribute to economic growth.

(Possible answer: Banks provide a link between savers and investors. Savers who deposit their money in banks make money available for farmers and business people who want to borrow money to start up or expand on a business venture. Also, banks increase the total amount of money available, which stimulates demand for goods and services.)

2. Explain why some politicians and voters in the 1830s wanted the Second National Bank to be rechartered, while others supported Jackson's veto.

(Possible answer: Supporters of the Second National Bank believed that the Bank kept banks from making too many loans. Making too many loans would increase the risk of bank failure and could lead to inflation. Opponents of the Bank felt that it was too powerful and that it was a tool of the wealthy. Many blamed banks for economic collapses and often for the loss of their own deposits.)

VISUAL 16.1

QUARTERBACKS: RECORDING DEPOSITS AND LOANS

DEPOSIT RECORD

Name	Number of Quarters Deposited
1. _____	_____
2. _____	_____
3. _____	_____
4. _____	_____
5. _____	_____
6. _____	_____

LOAN RECORD

Name	Number of Quarters Lent
1. _____	_____
2. _____	_____
3. _____	_____
4. _____	_____
5. _____	_____

ACTIVITY 16.1
QUARTERBACKS

<div>25¢</div> <div>Quarterbacks</div> <div>Redeemable for one quarter</div> <div>25¢</div>	<div>25¢</div> <div>Quarterbacks</div> <div>Redeemable for one quarter</div> <div>25¢</div>
<div>25¢</div> <div>Quarterbacks</div> <div>Redeemable for one quarter</div> <div>25¢</div>	<div>25¢</div> <div>Quarterbacks</div> <div>Redeemable for one quarter</div> <div>25¢</div>
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ACTIVITY 16.2

WHY DID ANDREW JACKSON DESTROY THE SECOND BANK OF THE UNITED STATES?

The First Bank of the United States was chartered by Congress in 1791 for a period of 20 years. The only nationally-chartered bank in the country, it had branches in many states. It made loans to the federal government and held government revenues from land sales, taxes and other sources. Most payments to the federal government were made in the form of state banknotes or checks. When the First Bank, acting for the government, presented notes or checks to a state bank, that bank had to exchange the notes for gold or silver. Often the state banks were not happy to do this, since it reduced their ability to make loans. However, the collection process was slow. First Bank usually did not press state banks to make gold and silver payments when times were bad.

Many people, particularly members of the business community, believed that the Bank provided a valuable service by keeping state banks from making too many loans and helping them through bad times by not insisting on prompt redemption of notes and checks. Also, people who knew something about economics realized that when too much money is created, there is a risk of inflation because buyers who have more money may be willing to pay higher prices in their competition for scarce goods and services.

The First Bank's charter was not renewed in 1811, primarily because of opposition from people who distrusted all banks or felt that a national bank transgressed the rights of states. However, the difficulties Congress experienced in financing the War of 1812 and a plague of bank failures and worthless bank notes from the western frontiers led Congress to charter the Second Bank of the United States in 1816, again for a period of 20 years.

Andrew Jackson, elected president in 1828 primarily by voters from the West and South, mistrusted all banks, as did most of the people who voted for him. The most unstable banks tended to be located in the West and South,

where there were also more farmers and fewer business people. Bank failures were frequent occurrences, and many depositors saw their life savings wiped out by them. Most Jacksonians believed that gold and silver were the only "true" forms of money, and most did not understand the relationship between the availability of money and economic growth.

The president of the Second Bank of the United States during Jackson's term of office was Nicholas Biddle. Biddle feared Jackson's anti-Bank convictions and was easily persuaded by Jackson's enemies in Congress to apply early for a recharter of the Bank. Led by Daniel Webster and Henry Clay, and under strong lobbying pressure from Biddle himself, Congress passed the recharter bill in 1832. But Biddle's interference in the legislative process increased Jackson's opposition to the Bank, and he vetoed the recharter bill.

Clay and his supporters believed that the veto would kill Jackson's chances for re-election, but instead Jackson easily won a second term in 1832. Inspired by his victory, he began to deposit government revenues into a carefully selected group of state banks, which his opponents called "pet banks," thus depriving the Second Bank of the United States of government deposits. In retaliation, Biddle demanded that state banks exchange gold and silver for the state bank notes and checks that the government held. The result was a series of bank failures, a reduction in loans to business people and farmers, and widening depression throughout the country. Biddle's former supporters in Congress turned on him and pressured him to stop his tightening of credit and the money supply. Biddle relented then, and the crisis ended.

Biddle's actions in this struggle with Jackson strengthened the belief of the Jacksonians that the Second Bank of the United States had too much power. The mood of distrust lasted beyond Jackson's term of office. An attempt to charter

ACTIVITY 16.2, CONTINUED

WHY DID ANDREW JACKSON DESTROY THE SECOND BANK OF THE UNITED STATES?

another national bank in 1841 was thwarted by President John Tyler, and in 1846 the Independent Treasury System was established, which cut all ties between federal governments funds and banks.

QUESTION FOR DISCUSSION

Historians and economists have argued for many years about Jackson's decision to destroy the Second National Bank. Do you agree or disagree with Jackson's decision? Give your answer in one or two paragraphs, explaining your reasons.